FILE COPY

Office Supreme Court
FILED
JAN 10 1933
CHARLES ELMORE CROPLEY

No. 475

In the Supreme Court of the United States

OCTOBER TERM, 1932

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

S. & L. BUILDING CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONER

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes and regulations involved	2
Statement	2
Specification of errors to be urged	7
Summary of argument	7
Argument	9
Conclusion	23
Appendix	24–26

CITATIONS

Cases:

American National Co. v. *United States*, 274 U. S. 99	9
Board v. *Commissioner*, 51 F. (2d) 73, certiorari denied, 284 U. S. 658	18
Bosshardt, Frank J., 4 B. T. A. 1262	22
Brewster v. *Gage*, 280 U. S. 327	22
Clemmons v. *Commissioner*, 54 F. (2d) 209	18
Commissioner v. *Moir*, 45 F. (2d) 356	18
Dalriada Realty Co., Inc., 5 B. T. A. 905	22
Fawcus Machine Co. v. *United States*, 282 U. S. 375	22
Fifty-three West Seventy-second Street, Inc., 23 B. T. A. 164	22
Ford v. *Commissioner*, 51 F. (2d) 206, certiorari denied, 284 U. S. 666	18
Graves Co., Inc., H. B., 1 B. T. A. 859	10
Hoover-Bond Co., 1 B. T. A. 929	10
Interstate Commerce Commission v. *New York, N. H. & H. R. Co.*, decided Nov. 21, 1932 (No. 15, October term, 1932)	22
Lucas v. *Schneider*, 47 F. (2d) 1006, certiorari denied, 284 U. S. 622	18, 20, 21
McCaughn v. *Hershey Chocolate Co.*, 283 U. S. 488	22
McWilliams, J. W., 15 B. T. A. 329	22
Metropolitan Properties Corporation, 24 B. T. A. 220	22
Murphy Oil Co. v. *United States*, decided Dec. 5, 1932 (No. 80, October term, 1932)	22
Pacheco Creek Orchard Co., 12 B. T. A. 1358	22
Todd, Inc., B. B., 1 B. T. A. 762	10
United States v. *Anderson*, 269 U. S. 422	9
United States v. *Grimaud*, 220 U. S. 506	21
United States v. *Kirby Lumber Co.*, 284 U. S. 1	18
Watson, Katherine H., 20 B. T. A. 270	22

Statutes:

	Page
Revenue Act of 1924, c. 234, 43 Stat. 253, 267—	
Sec. 212 (U. S. C., Title 26, Sec. 953)	9
Revenue Act of 1926, c. 27, 44 Stat. 9, 23, 41, 130—	
Sec. 212 (U. S. C. App., Title 26, Sec. 953(a))	24
Sec. 232 (U. S. C. App., Title 26, Sec. 984)	24
Sec. 1208 (U. S. C. App., Title 26, Sec. 953 (a))	25
Revenue Act of 1928, c. 852, 45 Stat. 791, Sec. 44 (U.S.C. Sup., V, Title 26, Sec. 2044)	22
Revenue Act of 1932, c. 209, 47 Stat. 169, Sec. 44	22
Miscellaneous:	
H. R. 356, 69th Cong., 1st Sess., p. 32	10
S. R. 52, 69th Cong., 1st Sess., p. 19	10
Treasury Regulations 33, Art. 116	10
Treasury Regulations 45—	
Art. 42	10
Art. 43	10
Art. 44	10
Art. 45	10
Art. 46	10
Treasury Regulations 62—	
Art. 42	10
Art. 43	10
Art. 44	10
Art. 45	10
Art. 46	10
Treasury Regulations 65—	
Art. 42	10
Art. 43	10
Art. 44	10
Art. 45	10
Art. 46	10
Treasury Regulations 69—	
Art. 44	12, 25
Art. 45	26
Treasury Regulations 74—	
Art. 352	22

In the Supreme Court of the United States

OCTOBER TERM, 1932

No. 475

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

S. & L. BUILDING CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONER

OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. 42–44) is reported in 60 F. (2d) 719. The findings of fact and opinion of the Board of Tax Appeals (R. 26–33) are reported in 19 B. T. A. 788.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 26, 1932. (R. 45.) Petition for certiorari was filed on October 25, 1932 (R. 45), and granted December 5, 1932 (R. 45). Jurisdic-

tion is conferred upon this Court by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether in computing the annual taxable income, upon the installment sales basis, from the sale of real estate subject to mortgages which are assumed by the purchaser, such mortgages not in excess of the basis to the seller (for determining gain or loss) should be excluded from the "total contract price" and the "initial payments" as provided in Article 44 of Treasury Regulations 69.

STATUTES AND REGULATIONS INVOLVED

The applicable statutes and regulations are set forth in the Appendix, pp. 24–26, *infra*.

STATEMENT

The facts material to the present issue, as found by the Board of Tax Appeals (R. 26–31), may be summarized as follows:

The respondent is a New York corporation engaged in the real estate business in New York City. During 1925 and prior years it obtained loans secured by mortgages upon its properties in order to finance its business. (R. 26.) It kept its books and made its income-tax returns upon the accrual basis. (R. 27.)

The respondent owned two pieces of property located, respectively, at 82nd Street and Broadway

and at 83rd Street and Broadway, which were acquired by it after March 1, 1913. The 82nd Street property was sold in 1924 for $2,100,000, of which $300,000 was paid in cash. For the balance of the purchase price the purchaser assumed a first mortgage of $1,100,000 and gave a purchase-money mortgage of $700,000. The depreciated cost of the property at the time of sale was $1,541,323.48, making a total profit on the sale of $558,676.52. In addition to the cash payment of $300,000, the respondent received installments on the purchase-money mortgage during 1924 in the amount of $30,000, and during 1925 in the amount of $36,250. During 1924 and 1925 the purchaser paid to the holders of the first mortgage, in accordance with the terms of sale, $22,000 and $44,000, respectively, the first mortgage being payable in installments of $22,000 each, due every six months beginning December 1, 1924, until April 9, 1933, when the entire balance becomes due and payable. (R. 28–29.)

The 83rd Street property was sold in 1925 for $2,165,000, of which $300,000 was paid in cash. For the balance of the purchase price the purchaser assumed a first mortgage of $1,100,000 and a second mortgage of $500,000 and gave a purchase-money mortgage of $265,000. The depreciated cost of this property at the time of sale was $1,522,033, making a total profit on the sale of $642,967. In addition to the $300,000 cash payment, the respondent received in 1925 $2,000 upon the purchase-money mortgage. The first and second mortgages as-

sumed by the purchaser exceeded the depreciated cost of the property to the respondent by the amount of $77,967. In 1925 the purchaser paid to the holders of the second mortgage the sum of $22,500. The first mortgage provided for payment in installments of $16,500 each, due May 1, 1926, and every six months thereafter until April 9, 1933, when the entire balance becomes due. The second mortgage provided for payment in installments of $7,500 each, due May 7, 1925, and every three months thereafter until November 7, 1934, when the entire balance becomes due. (R. 29–30.)

The Commissioner of Internal Revenue, in determining the respondent's tax liability for 1924 and 1925, computed the income from the sale of the two pieces of property on the installment basis. In computing the income upon such basis the Commissioner did not include as a part of the "initial payments" or of the "total contract price" the amount of the mortgages assumed by the purchasers. He included as part of the income received in 1925 from the sale of the 83rd Street property the amount by which the mortgages assumed exceeded the depreciated cost. By this method the Commissioner determined that the profit realized in 1924 on the sale of the 82nd Street property was $184,363.25, computed as follows (R. 30):

Profit to be realized	$558,676.32
Contract price	1,000,000.00
Percentage of profit to contract price	55.867652%
Cash payment plus installments received on purchase-money mortgage	330,000.00
55.867652% times $330,000 equals	184,363.25

Applying the same percentage to the installments of $36,250 received in 1925 on the purchase-money mortgage on the 82nd Street property, the Commissioner determined the realized profit for 1925 on that sale to be $20,252.02. (R. 30.)

By the same method the Commissioner determined a realized profit for 1925 on the sale of the 83rd Street property of $379,967, computed as follows (R. 30):

Profit to be realized	$642,967
Contract price	565,000
Percentage of profit to contract price	100% plus.
Initial payment	300,000
Installments on purchase-money mortgage	2,000
Excess of mortgages assumed over depreciated cost of property	77,967
Profit realized in 1925	379,967

The respondent claims that the profits realized annually from the sales of the two properties should be computed upon the installment basis as follows (R. 13–14):

1924

82nd Street and Broadway property:		
Gross profit		$558,676.52
Total contract price (purchase price)		2,100,000.00
Installment payments for 1924—		
Cash received	$300,000.00	
Payments received on purchase-money mortgage	30,000.00	
Amount paid to holders of first mortgage assumed	22,000.00	
		352,000.00
Percentage of profit ($558,676.52÷$2,100,000)		.26603644
Profit applicable to 1924		$93,644.83

1925

Installment payments on 82nd St. and Broadway sale—		
Payments received on purchase-money mortgage	$36,250.00	
Amount paid to holders of first mortgage assumed	44,000.00	
		$80,250.00
Percentage of profit		.26603644
Profit applicable to 1925 (82nd St. and Broadway)		$21,349.42
83rd and Broadway property:		
Gross profit		$642,967.00
Total contract price (purchase price)		2,165,000.00
Installment payments received in 1925—		
Cash received	$300,000.00	
Payments received on purchase-money mortgage	2,000.00	
Amount paid to holders of second mortgage assumed	22,500.00	
		$324,500.00
Percentage of profit ($642,967÷$2,165,000.00)		.29698245
Profit applicable to 1925 (83rd St. and Broadway)		$96,370.80

The Board of Tax Appeals approved the Commissioner's method of computing the profits realized in 1924 and 1925 from the sales of the 82nd Street and 83rd Street properties [1] (R. 32–33), but upon appeal the Circuit Court of Appeals reversed the decision of the Board, the court holding that Article 44 of Regulations 69, upon which the Commissioner based his computations, was not a proper interpretation of the statute. The court approved

[1] The Commissioner had determined deficiencies of $394.69 and $33,947.39 for 1924 and 1925, respectively. (R. 5.) Although the Board sustained the Commissioner with respect to the issues raised in this petition, its determination in favor of the taxpayer of other issues, not here involved, resulted in an order of no deficiency for 1924 and a deficiency of $29,645.85 for 1925. (R. 36.)

the respondent's method of computing the profit realized annually from the sales. (R. 42–44.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that Regulations 69, Article 44, in so far as it relates to the manner of computing income from the sale of real estate upon the installment basis, is invalid.

2. In not holding that Article 44, Regulations 69, is valid and in not applying the method of computation therein prescribed.

SUMMARY OF ARGUMENT

The statute authorizes the taxpayer to report as income in any year from the sale of real property on the installment plan that proportion of the "installment payments actually received" during the year which the total profit to be realized bears to the "total contract price." The purpose of the statute is to permit the taxpayer in such cases to defer reporting the gain as income until the actual receipt by the taxpayer of the cash or its equivalent. The statute prescribes the general formula to be applied, but does not undertake to define meticulously the factors to be used. The details essential to a proper application of the provisions of the statute to particular classes of cases were to be developed by regulations which the Commissioner was directed to adopt.

153017—33——2

Under the regulations adopted by the Commissioner the amount of mortgages assumed by the purchaser, not in excess of the basis of the property to the seller, is excluded from the "total contract price" as a factor in the ratio applicable in determining the profit received with each installment payment. Likewise, payments made by the purchaser to the holders of the mortgages assumed are excluded from the "installment payments actually received" to which the ratio is to be applied. To the extent, however, that the mortgages assumed exceed the basis to the seller, the amount thereof under the regulations is included in the seller's income for the year of sale, when by the assumption the taxpayer is relieved of primary liability.

The regulations limit the "total contract price" to the aggregate payments to be made to the taxpayer under the contract and the "installment payments" to actual receipts by the taxpayer. The regulations give effect to the clear purpose of the statute and having been adopted pursuant to express statutory authority they should be accorded the force and effect of law.

Under the ruling of the court below, holding the regulations invalid, there is no relation between the receipts by the taxpayer and the income chargeable to him, for by the method there sanctioned the taxpayer is charged with income measured to some extent at least by the receipts of another. The decision below is inconsistent with the general scheme

of the Revenue Acts and fails to give effect to the purpose of the statute in question.

ARGUMENT

IN COMPUTING ANNUAL INCOME FROM SALE OF REAL PROPERTY ON INSTALLMENT BASIS, MORTGAGES ASSUMED SHOULD BE EXCLUDED FROM "THE TOTAL CONTRACT PRICE" AND PAYMENTS THEREON TO MORTGAGEES SHOULD BE EXCLUDED FROM "INSTALLMENT PAYMENTS ACTUALLY RECEIVED" IN EACH YEAR BY THE TAXPAYER

There is no dispute as to the amount of profit accruing to respondent from sales of its realty in 1924 and 1925. The sole question is as to the time when it was realized and the manner in which it should be returned for income tax purposes.

Respondent makes its returns on the accrual basis (R. 27), and, except as otherwise permitted by statute, would be compelled to return its total profits as income in the years in which they accrued, that is, in the years the sales were made. See Revenue Act of 1924, c. 234, Sec. 212 (b), 43 Stat. 253, 267 (U. S. C., Title 26, Sec. 953); *American National Co.* v. *United States,* 274 U. S. 99; *United States* v. *Anderson,* 269 U. S. 422.

By Section 212 (d) of the Revenue Act of 1926, *infra,* the taxpayer is authorized to return, under regulations prescribed by the Treasury Department, income from the sale of real estate upon the installment basis, if the "initial payments" do not exceed one-fourth the "purchase price." It is provided that in such cases the taxpayer may return

as income each year that proportion of "the installment payments actually received" in the taxable year, "which the total profit realized or to be realized when the payment is completed, bears to the total contract price." Although the two sales here in question took place in 1924 and 1925, respectively, before enactment of the Revenue Act of 1926, Section 1208 of that Act, *infra,* provides that subdivision (d) of Section 212 shall be retroactively applied in computing income under the provisions of the 1924 Act.

The Revenue Acts prior to 1926 did not contain any express authority for reporting income on the installment basis, but the right to do so was contained in regulations promulgated by the Commissioner with the approval of the Secretary of the Treasury.[2] These regulations, however, were held unauthorized and invalid by the Board of Tax Appeals. *B. B. Todd, Inc.,* 1 B. T. A. 762; *H. B. Graves Co., Inc.,* 1 B. T. A. 859; *The Hoover-Bond Co.,* 1 B. T. A. 929. To meet the situation thus created Section 212 (d), *infra,* was inserted in the 1926 Act in order to validate the "principles of the Commissioner's regulations." (Senate Report No. 52, 69th Cong., 1st Sess., p. 19.) It is stated in the Conference Report (H. R. No. 356, 69th Cong., 1st Sess., p. 32):

[2] Article 116, Regulations 33 (Revenue Acts of 1916 and 1917); Articles 42 to 46, inclusive, Regulations 45 (Revenue Act of 1918); Articles 42 to 46, inclusive, Regulations 62 (Revenue Act of 1921); Articles 42 to 46, inclusive, Regulations 65 (Revenue Act of 1924).

> This amendment writes into the bill the basic principles of the installment method authorized by prior regulations. * * *

The purpose of the statute undoubtedly was to confer upon the taxpayer the privilege of restricting taxation of the gain derived from a completed transaction of the character described to the actual receipt in each taxable period of cash or its equivalent. This was done by treating as income a ratable proportion of the receipts in each year from the transaction. The statute describes the transactions to which it is applicable and provides the general formula to be used in applying its provisions. Congress did not, however, undertake to prescribe meticulously the formula to be applied or to define the factors to be employed in all cases. Quite obviously the statute provides only for the simple and usual case of sale of property upon the installment plan. It does not purport to set out all the details material to an application of the general formula, especially in the more complex cases of sales of real property subject to existing mortgages. Section 212 (d) contains three terms, definition of which is essential to the application of the section. These terms are "initial payment," "total contract price," and "purchase price." The section defines "initial payments," but not the other two terms. These details in the administration of the statute were left for the Commissioner of Internal Revenue to prescribe in regulations which the statute directed be adopted.

Under this authority, Article 44, of Regulations 69, in which these terms were defined, was promulgated. This Article provides that in the sale of mortgaged property the amount of the mortgage, whether the property is taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall not be considered as a part of the "initial payment" or of the "total contract price," except to the extent that the mortgage may exceed the cost or other basis to the seller.

In the regulations prior to those under the 1926 Act, there was no express reference to the treatment of mortgages assumed by the purchaser. Article 44, Regulations 65, under the 1924 Act, was substantially the same as Article 44 [3] in Regulations 69, except the last paragraph which reads as follows:

> In determining how these classes shall be treated in levying the income tax, the question in each case is whether the income to be

[3] As originally promulgated on August 28, 1926, the last paragraph of Article 44, Regulations 69, reads as follows:

"In the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall not be considered as a part of the 'initial payments' or of the 'total contract price,' but shall be included as part of the 'purchase price,' as those terms are used in section 212 (d), in articles 42 and 45, and in this article. Commissions and other selling expenses paid or incurred by the vendor are not to be deducted or taken into account in determining the amount of the 'initial payments,' the 'total contract price,' or the 'purchase price.'"

> **reported for taxation shall be based only on amounts actually received in a taxing year, or on the entire consideration made up in part of agreements to pay in the future.**

In the instant case the vendee in each sale assumed mortgages placed upon the properties by the respondent. The 1924 sale is typical of the usual sale of real property encumbered with a mortgage, where the amount of the mortgage which is assumed by the purchaser as part of the total consideration is less than the depreciated cost or other basis of the property to the seller. The 1925 sale presents the unusual case infrequently encountered in the administration of the installment sales provision of the statute, where the amount of the mortgages assumed by the purchaser is greater than the depreciated cost or other basis of the property to the seller. The problem presented in such cases is how the mortgages which are assumed as part of the total consideration for the property shall be treated in determining the factors to be used in the formula prescribed by the statute.

Whether the statute is applicable to a particular sale depends upon the relation of the amount of the initial payment, which is defined by the statute, to the total consideration. In this case it is not disputed that the statute is applicable to both sales. In the application of the statute it is essential that there be a determination of the percentage of profit and the amount of the payments re-

ceived in each year to which the percentage is to be applied. The percentage of profit is the ratio of the "total profit" to the "total contract price" and a proper interpretation of the term "installment payments actually received" is determinative of the amount to which the percentage must be applied. These material terms are not defined by the statute, but only by the regulation.

The court below, holding the regulation invalid and sustaining the respondent's method of computing the annual profit on the sales, was of the opinion that the amount of the mortgages assumed by the purchaser should be included in the "total contract price," as a factor in the ratio prescribed by the statute, and that payments by the purchaser to the mortgagee upon the assumed mortgages should be included in "installment payments actually received" as and when such payments are made.

The decision below, we submit, does not conform to the statute and fails to give effect to its purpose. Under the construction adopted by the court, the terms "installment payments actually received" and "total contract price" bear no relation to receipts by the taxpayer (seller), but are measured by payments made by the purchaser to both the taxpayer and third persons, holders of the mortgages assumed. As a result the taxpayer may be required to report income in a year in which he has received nothing and even in years long after he has received all payments due him. Such a result

is inconsistent with the general scheme of accounting contemplated by the Revenue Acts and measures the taxpayer's income, to some extent at least, by the receipts of another. This, it is believed, was not contemplated by Congress, which must have intended apportioning only the payments received by the taxpayer.

Moreover, the decision of the court below presents great difficulties of administration. Under that decision it is necessary to take account of the payments made by the purchaser in each year, not only to the taxpayer but also to the holders of the mortgages, which latter payments are not necessarily reflected on the taxpayer's books. The obstacles thus confronting the Treasury Department in the proper audit of the returns of the taxpayer and in the assessment and collection of taxes are obvious. These obstacles are even more serious in the event of subsequent transfers of the mortgages or the property. Further difficulties would be encountered were a corporate taxpayer, like the present respondent, to dissolve before all payments upon the mortgage have been completed by its vendee.

The regulation (Article 44, Regulations 69), on the other hand, provides the most logical and practicable method for giving effect to the intent and purpose of the statute, and is free from the serious defects inherent in the method sanctioned by the court below. The regulation provides that the amount of assumed existing mortgages shall be in-

cluded in the "purchase price" but, to the extent it does not exceed the "basis" (for determining gain or loss), shall not be included as part of "the initial payments" or of "the total contract price." Under the rule thus prescribed the amount of assumed mortgages, while considered a part of the total consideration for the sale, is excluded from "the total contract price," which is taken to mean the aggregate payments to be received *by the seller alone*. Likewise, payments on the assumed mortgages are excluded from the "installment payments actually received," which latter phrase is taken to mean only installment payments received by the seller. The excess, if any, of the assumed mortgages over the "basis" is treated as income realized at the time liability is assumed by the purchaser.

We believe that the statute contemplates apportioning only the payments actually received in each year by the taxpayer in the ratio that total profit on the transaction bears to the aggregate amount to be received by the taxpayer under the contract. This seems to be the clear import of Section 212 (d), which permits the taxpayer to return as income a proportion of the installment payments actually received during the year. The method prescribed by the regulations effectuates this purpose of the statute and conforms to the general scheme of the Act to measure the tax by the receipts of the person subject to the tax. By this method the respondent will have reported as income the entire amount of its gain on the sales by the time the payments due

to it are completed. Payments made and to be made to third persons as holders of the mortgages assumed are eliminated from consideration in apportioning the income taxable annually to the respondent. Under the method sanctioned by the court below there is no relation between the respondent's receipts and the amount of income chargeable to it. The only use of "total contract price" is as a factor of the ratio by which annual receipts are apportioned between income and return of cost of the property to the taxpayer. The regulation, by excluding therefrom assumed mortgages, gives the term the meaning of the total amount of money or its equivalent to be received by the seller under the contract and likewise limits the installment payments to actual receipts by him. This method seems to us the only one consistent with the purpose of the statute and affords the only practical rule for proper administration.

The court below suggests that the regulation is inconsistent in that the mortgages assumed, to the extent they exceed the basis (for determining gain or loss) of the property to the seller, are required to be treated as part of the total contract price and also of the initial payments received by the seller in the year of sale, while the balance of the mortgages are excluded from the computation. These were the conditions obtaining in the sale made by the respondent in 1925. The suggested inconsistency, we submit, is more apparent than real. The excess of assumed mortgages over the "basis" is properly

treated as realized income to the taxpayer at the time of assumption of liability by the purchaser, for the taxpayer is then relieved of primary liability; and to the extent of such excess, theretofore received as a loan, the taxpayer has at that time derived income.[4] See *United States* v. *Kirby Lumber Co.*, 284 U. S. 1.

Somewhat the same situation as obtained here in the 1925 sale was involved in *Lucas* v. *Schneider*, 47 F. (2d) 1006 (C. C. A. 6th), certiorari denied, 284 U. S. 622, where the regulation in question was upheld. In that case the question was whether the transaction constituted an installment sale. If the sum by which the assumed mortgages exceed the basis were treated as part of the "initial payments," as provided by the regulation, such payments would amount to more than one-fourth of the

[4] While it is true that there is a contingency that at a later date the vendor of encumbered property may be compelled by his vendee's default to satisfy his secondary liability by paying off the mortgage, this circumstance does not affect the taxability of the amount of the mortgage in excess of the basis of the property to the vendor. It is settled that a transaction otherwise closed is not uncompleted and that the receipt of income is not deferred for purposes of taxation beyond the year in which received merely because there exists some potential liability by reason of which a loss may be sustained. See *Clemmons* v. *Commissioner*, 54 F. (2d) 209 (C. C. A. 5th); *Ford* v. *Commissioner*, 51 F. (2d) 206 (C. C. A. 6th), certiorari denied, 284 U. S. 666; *Board* v. *Commissioner*, 51 F. (2d) 73 (C. C. A. 6th), certiorari denied, 284 U. S. 658; *Commissioner* v. *Moir*, 45 F. (2d) 356 (C. C. A. 7th). In the event of such later loss, a deduction is proper as of the date when it is incurred.

purchase price, and the sale would not be an installment one. The taxpayer claimed such sum should be excluded, but the court sustained the provision of the regulation requiring its inclusion. The court said (p. 1008):

> By virtue of his authority under section 1101 of the Revenue Act of 1926 (26 USCA §1245), the Commissioner on August 28, 1926, promulgated Internal Revenue Regulation No. 69, and by article 44 thereof excluded the mortgages from the initial payments. Regardless of whether this was a valid regulation, it was accepted by the Board of Tax Appeals as legally and equitably sound when applied to the facts of the particular cases coming before the Board. See *Dalriada Realty Co.*, 5 B. T. A. 905, 908; *Watson* v. *Comm'r*, 20 B. T. A. 270, 272; see also *Pacheco Creek Orchard Co.*, 12 B. T. A. 1358; and *J. W. McWilliams*, 15 B. T. A. 329. But in none of these cases did the mortgages exceed the basis to the vendor of the property sold. The case in hand presents a different situation. Here the mortgages did exceed the basis to the vendor in the sum of $37,802.54, and the situation is controlled by the last paragraph of art. 44 as amended by Treasury Decision No. 4255, which provides that, "in the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser—to the extent it does not exceed the basis to the vendor of the property sold—

> shall not be considered as a part of the initial payments," provided article 44 as thus amended is a valid regulation. We see no reason for questioning its validity in this case. It adds nothing to initial payments which may not be added under the statute. We think the effect of it was to reflect more clearly the real meaning of the statute and to require the income to be returned during the taxable period in which it was received.

That case and the instant one are distinguishable in that here the "initial payments" including the excess of the assumed mortgages over the "basis" did not exceed one-fourth the purchase price and hence the installment provisions concededly are applicable; but the court in the *Schneider case* could not have reached the result of the decision without approving the regulation now attacked.

No inconsistency results from excluding the amount of the assumed mortgages not in excess of the "basis" from the "total contract price" and the payments thereon from "installment payments actually received," for payments on such mortgages are not to be made to the taxpayer; and while counted in full as part of the total consideration for the sale, the assumption of the mortgages to the extent not in excess of the "basis," may properly be treated as a return of the "basis," and hence excluded from both factors of the ratio applicable in computing the amount of income realized by the taxpayer from each installment pay-

ment. To the extent of the excess of the assumed mortgage over the basis, on the other hand, there is a gain to the taxpayer, the full benefit of which is received in the year of sale just as much as though it were received in cash or other property. *Lucas* v. *Schneider, supra,* approves the method of dealing with such an excess amount prescribed by the regulation, and we submit no good reason appears for not following that method in the present case.

It is expressly provided in Section 212 (d) that the permission to return income on the installment basis is conditioned upon compliance with regulations prescribed by the Commissioner with the approval of the Secretary. Thus Congress indicated its intention that the administrative officers should work out the details of the application of the principle adopted. In *United States* v. *Grimaud,* 220 U. S. 506, 517, this Court upheld the power of Congress to give to those charged with the administration of the law " 'power to fill up the details' by the establishment of administrative rules and regulations, * * *." The regulations are valid and binding unless unreasonable or inconsistent with the statute. Not only is this regulation reasonable and consistent with the statute, but it effectuates its purposes in a practical manner. The theory of the court below conflicts with the purpose and intent of the statute, and with the principles of installment accounting. It would be impossible

to determine from any of the usual accounting records that might be kept by the respondent what its income was in any year, since payments made by the purchasers to the holders of the mortgages would not be reflected in such records.

The regulation nullified by the decision of the court below has been consistently upheld by the Board of Tax Appeals. See *Frank J. Bosshardt*, 4 B. T. A. 1262; *Dalriada Realty Co., Inc.*, 5 B. T. A. 905; *Pacheco Creek Orchard Co.*, 12 B T. A. 1358; *J. W. McWilliams*, 15 B. T. A. 329; *Katherine H. Watson*, 20 B. T. A 270; *Fifty-three West Seventy-second Street, Inc.*, 23 B. T. A. 164; *Metropolitan Properties Corporation*, 24 B. T. A. 220. Moreover, the statute to which the regulation applies was substantially reenacted in the Revenue Act of 1928, c. 852, Sec. 44 (b), 45 Stat. 791, 805, and in the Revenue Act of 1932, c. 209, Section 44 (b), 47 Stat. 169, 186. Regulations 74, Article 352, applicable to the 1928 Act, repeat, so far as presently material, the regulations now in question. Under these circumstances, the administrative interpretation of the statute should not be disregarded. See *Murphy Oil Co.* v. *Burnet*, decided December 5, 1932 (No. 80, October Term, 1932); *Interstate Commerce Commission* v. *New York, New Haven & Hartford R. Co.*, decided November 21, 1932 (No. 15, October Term, 1932); *McCaughn* v. *Hershey Chocolate Co.*, 283 U. S. 488, 492; *Fawcus Machine Co.* v. *United States*, 282 U. S. 375; *Brewster* v. *Gage*, 280 U. S. 327, 337.

CONCLUSION

The decision below is erroneous and should be reversed.

Respectfully submitted.

THOMAS D. THACHER,
Solicitor General.

G. A. YOUNGQUIST,
Assistant Attorney General.

WHITNEY NORTH SEYMOUR,
SEWALL KEY,
JOHN MACC. HUDSON,
Special Assistants to the Attorney General.

WALTER GELLHORN,
Attorney.

JANUARY, 1933.

APPENDIX

STATUTES AND REGULATIONS

REVENUE ACT OF 1926, C. 27, 44 STAT. 9, 23, 41, 130

SEC. 232. In the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206, and the net income shall be computed on the same basis as is provided in subdivisions (b) and (d) of section 212 or in section 226. * * * (U. S. C. App., Title 26, Sec. 984.)

SEC. 212. (b) The net income shall be computed * * * in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but * * * if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

* * * * *

(d) Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the payment is completed, bears to the total contract price. In the case (1) of a casual sale or other casual disposition of personal property for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if

in either case the initial payments do not exceed one-fourth of the purchase price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this subdivision. As used in this subdivision the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made. (U. S. C. App. Title 26, Sec. 953.)

SEC. 1208. The provisions of subdivision (d) of section 212 shall be retroactively applied in computing income under the provisions of * * * the Revenue Act of 1924, * * *. (U. S. C. App., Title 26, Sec. 953 (a).)

TREASURY REGULATIONS 69

ART. 44. *Sale of real property involving deferred payments.*—Under section 212 (d) deferred-payment sales of real property fall into two classes when considered with respect to the terms of sale, as follows:

(1) Sales of property on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made do not exceed one-fourth of the purchase price.

(2) Deferred-payment sales not on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made exceed one-fourth of the purchase price.